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FORMAL ADVERTISING AND NEGOTIATION;
THEIR PLACE IN GOVERNMENT PROCUREMENT

THOMAS C. GOSLIN

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FORMAL ADVERTISING AND NEGOTIATION
THEIR PLACE IN GOVERNMENT PROCUREMENT

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Thomas C. Goslin, Jr.

FORMAL ADVERTISING AND NEGOTIATION
THEIR PLACE IN GOVERNMENT PROCUREMENT

by

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Submitted in partial fulfillment of
the requirement for the degree of

MASTER OF SCIENCE
IN
MANAGEMENT

United States Naval Postgraduate School
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ABSTRACT

Government procurement is no doubt the largest single source of income for private industry. Each year there is many billions of dollars spent to supply the needs of the military and other governmental departments.

As a result of Congressional action in the form of statutes, procurement personnel are restricted in their actions when buying the material and supplies required. This paper endeavors to explain the different methods of contracting available to the contracting officer and the various types of contracts that may be placed. Since the most desirable method, to the Congress, formal advertising is not considered to be advantageous to the writer, this paper was undertaken. An objective review of both negotiation and formal advertising is presented, however, the conclusion must be reached that negotiation is superior.

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INTRODUCTION

Having had a tour of duty as a contracting officer at the Navy Purchasing Office in Washington, D.C. and also being ordered to the contracts division of the Bureau of Naval Weapons, prompted me to undertake this study.

I think of no better preface than the opening remarks of Captain J. L. Howard, SC, USN, in the Navy Management Review, March, 1965.

Procurement faces greater challenges today than ever before. On the one hand, ways must be found to shorten the administrative lead-time, simplify the purchasing processes, and consummate contracts more rapidly in keeping pace with naval operating commitments.

On the other hand, procurement must inject its influences for economy and sound business practice at progressively earlier stages of the weapons acquisition decision-making cycle.

Underlying these challenges is the need for constant awareness of the impact of the Navy's procurement programs on the American industrial community.

Our economic philosophy is clearly reflected in the kind of contracting we do. We must purposefully strengthen the private enterprise system and reinforce the concept of a freely-operating, highly competitive, multi-seller market place where risks are real, where the rewards for efficiency and the penalties for inefficiency are clear-cut and certain.

This is why it is important that we encourage competition, open new sources, and inject risks and incentives into our contracts.

Naval procurement has demonstrated its ability in the past to introduce new approaches and improved techniques in the expenditure of nearly nine billion dollars annually. It will continue to make its good business contribution to the weapons acquisition process, and it is proud of its full and respected partnership with the technical and operating functions in assuring that the United States Navy remains strong, trim and combat ready.

With these thoughts in mind, I hope to be able to present a clear picture of the methods and place in government contracting for both formally advertised and negotiated types of procurements. They both play a

major roll in the billions of dollars that are spent annually in an effort to keep our home and country free of Communist aggression.

I would also like to express my sincere thanks to Commander W. R. Baker for his consistant help as my advisor on the study, and to my dear wife, Bet, for her many hours of typing and proof reading.

I

BACKGROUND

In the years prior to World War II, procurement in the Navy had been accomplished through a mass of uncoordinated legislation that had been in affect for as much as one hundred years. Some statutes still existed that had been enacted to serve special interests of the time. At this point in time, these statutes now become a hinderance to effective and rapid procurement of supplies and services.

When World War II started on December 7, 1941, Congress immediately realized the need to make drastic changes in the procurement laws. The First War Powers Act, which was signed by the President on December 18, 1941, was the first of many pieces of legislation and executive orders that would free the Navy of the shackles of antiquated laws.¹

Actually this was the termination of several previous acts dating back to 1939, which set the stage for a build up of the military might of the United States in the face of the existing strife in both Europe and Asia. Further implementation was accomplished by the President's delegation of authority to the Secretary of the Navy and the Chiefs of the cognizant Navy Bureaus, the right to determine if the price was both fair and reasonable. Furthermore, they were authorized to execute contracts on behalf of the government.²

¹Office of the General Counsel, Navy Contract Law (Washington: Government Printing Office, 1959), pp. 7-8.

²Office of the President, Executive Order 8891 of September 4, 1941 supplemented by Presidential letter of October 7, 1941.

In 1945, after the completion of World War II, the War Production Board, through its Procurement Policy Board, recommended that government agencies propose procurement policies to replace the emergency procurement legislation when it expired. As a result, the proposed legislation, while retaining for the most part the formal advertising method of procurement, made provision for broad authority to negotiate the price and other terms when judgment and other circumstances so warranted. In addition, it indicated that formal advertising would be eliminated during any period of national emergency. The Board pointed out a number of areas in which formal advertising was both expensive and inadequate. These areas were to later become the exceptions under which the authority to negotiate a contract was given.

Following the recommendations, a bill was initiated and introduced in the 80th Congress on January 27, 1947. It was known as the Armed Services Procurement Bill. It would at last set forth one group of policies and regulations to be used by all services in the procurement of supplies and services. It would also remove the archaic laws that had hindered military procurement for many years prior to the war. The bill was approved by the President on February 18, 1948, as Public Law 413 of the 80th Congress.

The act, in addition to authorizing negotiated purchases where situations require or justify a departure from formal advertising, also allows the use of that type of contract best adapted to the situation at hand, without blind adherence in every instance to the fixed price, formally advertised type of contract.

³United States Congress, National Security Act of 1947 (Washington: Government Printing Office, 1948).

Congress, at the same time, was very explicit in its desire to regulate any buys made by the Navy. It required that no procurements should be made unless they were covered by an appropriation that had been passed by Congress. Appropriation requests are proposed in standard form by each agency, working with the Bureau of the Budget, who in turn reviews, approves and consolidates the requests of all the executive agencies prior to the President's submission of the budget to Congress. Appropriations are made, even through the Navy as part of the Department of Defense is now using the Five Year Force and Financial Plan, by object classification covering broad categories of goods. These goods would include supplies and materials, equipment and other contractual services. Funds may be transferred between object classes in accordance with changing needs. However, from a realistic viewpoint, if the budget estimates are reasonably accurate, expenditures are substantially limited to the amounts appropriated in each classification. The law also states, that, with a few exceptions, funds must be obligated during the fiscal year for which they were appropriated.

In essence, it is the intent of Congress to channel demand into predetermined categories, and to make this demand potentially effective for the fiscal year beginning from the time the appropriation is approved.⁴

The enactment of the Armed Services Procurement Act gave new impetus to post-war coordination of procurement among the Services. Section 10 of the act enabled the Services to agree upon the performance of procurement functions by one Service for all of the others. It also auth-

⁴Dickson Reck, Government Purchasing and Competition (Los Angeles: University of California Press, 1954), p. 10-11.

orized them to create joint or combined offices such as the Defense Supply Agency, to perform procurement functions and responsibilities. This authority has come into wide use, as evidenced by the fact that at present, a very substantial portion of all moneys spent by the three military departments is subject to either: (a) single department buy, where one Service is responsible for the purchase of goods for all of the Services either on the basis of product assignment or plant cognizance or, (b) single manager assignment, where the Service designated as single manager agency buys and performs certain supply management functions with respect to certain common-use supplies and services for all the Departments. Since 1961 though, the Secretary of Defense has been establishing various Defense agencies, such as Defense Supply Agency, who will take over as a central procurement agency for all the Services.

This coordination among the Services in procurement matters is by no means confined to the assignment of purchase responsibilities. During World War II, there was virtually no consciously developed uniformity of approach between the Army and Navy in their procurement practices and procedures with but two exceptions. These were the areas of contract administration and renegotiation. Since 1946, huge strides have been taken toward unifying the procurement policies and practices of all the Services. Having for the first time in our country's history a common and uniform statutory basis for buying under the Armed Services Procurement Act, there has developed among all procurement personnel a feeling of collaboration, interchange of ideas and common approach to matters. The most notable being the development of the Armed Services Procurement Regulation fondly known as ASPR.

In general, all of the new sections of ASPR were originally prepared by working subcommittees of specialists within a department, each working in his own speciality. These sections were then submitted for comments and the consideration of each of the Departments and to various representatives of management in the industrial complex. The final review was made by a special editing group and intermediate approval was given by a designated ASPR Committee. This committee was made up of representatives of the Military departments and the Department of Defense. Originally, the final approval was given by the Procurement Secretaries of the various Departments and the final drafts were cleared with the Munitions Board and its Procurement Policy Council. This policy has now been changed and approval of the ASPR Committee is sufficient, without the need for further review, except where there are major policy matters to be implemented or there is a disagreement within the ASPR Committee. When this is the case, the matter is referred to the Assistant Secretary of Defense (Supply and Logistics) for resolution in coordination with the various Material Secretaries of the Departments.

The membership of the ASPR Committee includes a specialist in procurement as well as a legal representative from each of the military departments and also two representatives appointed by the Assistant Secretary of Defense (Supply and Logistics), one of whom is designated the chairman of the committee. To aid in the accomplishment of their mission, the ASPR Committee has various subcommittees composed of both procurement and legal representatives from each of the military departments. They work in conjunction with a permanent staff which has been established by the Assistant Secretary of Defense (Supply and Logistics). When a proposed change or addition has been approved, the ASPR Committee

will then refer the case to the ASPR Editing Subcommittee which is composed of lawyers from the Army, Navy, and Air Force. They, in turn, will do the editing prior to final inclusion in the regulation.

The Armed Services Procurement Regulation specifically provides that each Department shall implement the regulation by departmental procedures, such as NPD, but they must not be inconsistent with, nor in repetition of, the regulation. Each individual agency, within a Department, may also prescribe detailed operating instructions which may not be in disagreement with either the ASPR or the operating policies of the applicable Department.

Within the Navy, implementation of the Armed Services Procurement Regulation is accomplished by means of the Navy Procurement Directives (NPD). Also, within each of the various Bureaus and Agencies of the Navy Department, operating instructions and policy are also issued which implement the ASPR and NPD. Probably the most important of these implementing instructions is the Bureau of Supplies and Accounts Manual, Volume VI (Purchasing). This manual not only prescribes detailed procurement actions and rules for use in the field activities, but also gives a broad picture that may be used as an operational guide.

To summarize the background section, below is a list of the principal statutes covering military procurement that has been issued or amended since the end of World War II. It must be remembered that these are the basic laws and many Executive Orders and Departmental instructions, too numerous to mention, have been issued to implement these laws.

1. The Armed Services Procurement Act of 1947, as amended (10 U.S.C. 2301-2314). This is the original comprehensive revision and restatement of the laws governing the procurement of supplies and services of the

military departments.

2. The Federal Property and Administrative Services Act of 1949 (40 U.S.C. 471-524, 41 U.S.C. 251-260). This act governs the procurements by the civilian departments and agencies such as the General Services Administration.

3. Public Law 85-804 (50 U.S.C. 1431-1435). This is the re-enactment of the former Title II of the First War Powers Act of 1941. It gives to the President, during a national emergency, the power to authorize defense agencies to waive statutory restrictions in the making, performance and modification of contracts when, in his opinion, it is in the best interest of national defense.

4. The Budget and Accounting Act of 1912, as amended (31 U.S.C. 1-60). This act, which also created the Bureau of the Budget and the General Accounting Office, requires the President to submit the proposed annual budget to the Congress.

5. The Budget and Accounting Act of 1950, as amended (31 U.S.C. 2-65). This act required the President's budget to set forth the functions and activities of the government.

6. The Defense Production Act of 1950, as amended (50 U.S.C. app. 2061-2166). By this act, the Business and Defense Services Administration, within the Department of Commerce, administers the powers delegated by the Office of Emergency Planning to establish priorities in the performance of defense contracts and to properly allocate materials and facilities for the purpose of promoting the national defense. The act also covers the governments responsibility for all types of loans.

7. The Renegotiation Act of 1951, as amended (50 U.S.C. App. 1211-1233). This act established the Renegotiation Board, whose function is

to eliminate excessive profits from contracts or subcontracts with government agencies. The Board is authorized to determine what portion of profits, governed by the Act, are "excessive" and require that such profits be returned to the government.

— 8. The Walsh-Healey Public Contracts Act, as amended (41 U.S.C. 35-45). Under this act, requirements are established whereby contractors awarded contracts of more than \$10,000 must: (1) Be a manufacturer of or a regular dealer in the materials to be furnished; (2) Pay no less than the prevailing minimum wage as established by the Secretary of Labor; (3) Not allow his employees to work more than an 8 hour day, or 40 hours per week; (4) Not employ convict labor, males under 16 years and females under 18; and (5) Not permit the work under the contract to be performed in an unsafe, unsanitary or hazardous area.

— 9. The Eight-Hour Law of 1912, as amended (40 U.S.C. 321-325). This act forbids the working by any contractor personnel in excess of 8 hours per day unless they are paid at a rate of one and one half the basic rate for the overtime. This law is not applicable to contracts containing the Walsh-Healey Act.

— 10. The Davis Bacon Act, as amended (40 U.S.C. 276a-276a-7). The provisions of this act are similar to those of the Eight-Hour Law, except that it is applicable to construction contracts. It does carry one additional provision, namely, that wages must be paid at the site of the work, at least once a week.

✓ 11. Anti-Kickback Acts (18 U.S.C. 874; 40 U.S.C. 276a; 41 U.S.C. 51-54). These acts, again in the construction field, provides for criminal punishment to anyone who requires another individual to give up any part of the compensation he earns under his employment on construction work. In

addition, there is a provision to prevent any subcontractor to pay any fee to an employee of a prime contractor, or an employee of a higher tier subcontractor as an inducement to perform services for the government.

12. The Miller Act (40 U.S.C. 270a-270e). Also, in the construction field, this act requires that prior to award of any government contract in excess of \$2,000 for the construction, alteration or repair of any public building or work, the contractor is required to furnish a performance bond for the protection of the government and a payment bond for the protection of the workers under the contract.

13. The Assignment of Claims Act of 1940, as amended (31 U.S.C. 203; 41 U.S.C. 15). This act provides that any moneys due or that may become due under a contract that exceeds \$1,000, may be assigned to a bank, trust company, or other financial institution including any federal lending agency. The act also provides that during a time of emergency, any contract of the federal government may provide that moneys due the assignee shall not be subject to reduction by liabilities of the assignor to the United States which might arise independent of the contract.

14. The Buy American Act, as amended (41 U.S.C. 10a-10d). By this act, only such unmanufactured materials as have been mined or produced in the United States, and only such manufactured supplies as have been manufactured in the United States, shall be acquired for use in the United States, unless, it is determined by the agency or department head that it is in the public interest or that the prices proposed by the domestic source are unreasonable. This Act is also applicable to construction contracts.

15. The Disputes Act of 1954 (41 U.S.C. 321, 322). This act provides that a decision of the head of department or his duly authorized representative, such as a Contracting Officer, pursuant to the appropriate clause within the contract, shall make a decision, which will be final and conclusive, unless such decision is fraudulent, capricious, arbitrary or grossly erroneous so as to imply bad faith, or cannot be supported with substantial evidence. However, this final decision is always subject to review by the Armed Services Board of Contract Appeals.

16. The Tucker Act, as amended (28 U.S.C. 1491). This act provides that the Court of Claims will decide matters in claims against the United States based on the Constitution, any Act of Congress, any regulation of the Executive department, any expressed or implied contract with the government, and for liquidated or unliquidated damages in cases not sounding in tort.

17. The Atomic Energy Act of 1954, as amended (42 U.S.C. 2011-2296). This act provides for programs in the field of Research and Development; the control and dissemination of scientific information; government control of the use, possession, and production of atomic energy and any types of nuclear fission material; the encouragement of widespread development and utilization of nuclear materials for peaceful purposes and to encourage world wide participation in the efforts to preserve peace for all mankind through the use of atomic energy. The prime responsibility of this program rests in the hands of the Atomic Energy Commission.

18. The National Aeronautics and Space Act of 1958, as amended (42 U.S.C. 2451-2476). This act was responsible for the establishment of the National Aeronautics and Space Administration whose prime purpose is the expansion of knowledge regarding the phenomena in the atmosphere and

also in space. It is also charged with the responsibility for long range planning to best utilize the resources of the United States for a better world through space exploration, again with the idea of peaceful and scientific purposes in mind.

This has been a brief resume of the many regulations that face our procurement people each day. In the next chapters an explanation of the type of contracts and the various methods of procurement will be undertaken.

II

TYPES OF CONTRACTS

Prior to discussing the methods used for the execution of a procurement request, I should like to describe the types of contracts and their application in government procurement.

Firm Fixed Price. This is the most preferred type of contract since it places the full risk of performance on the contractor. A fixed sum of money is paid for a unit, item or assembly delivered by the contractor to the government. A firm fixed price contract provides the maximum incentive for efficient performance, thus producing a higher rate of profit. This type of contract may be used in either of the two methods of procurement, formal advertising or negotiation. It is suitable for use under the following circumstances:

1. Definitive specifications are available for the required supplies or services.
2. There are at least two known suppliers to compete for the award of the contract.
3. The selection of the successful bidder may be made on price alone.
4. There is sufficient time available to complete the entire procurement cycle from solicitation to award of the contract.

The fixed price contract is especially suitable in the purchase of standard commercial items, or military items for which accurate prices have or may be developed.⁷

Fixed-Price with Escalation. The fixed-price with escalation con-

⁷Armed Services Procurement Regulation (Washington: Government Printing Office, 1949), 3-404.2.

tract provides for an upward or downward revision to the contract price at such a time that certain contingencies might arise. These contingencies must be defined in the contract and are normally in the areas of Labor, Material and Price. When escalation is agreed upon, upward adjustment will have a limitation that is established by a ceiling, and provisions will be included for downward adjustments, when prices fall below that of the base level provided in the contract. The main use of this type of contract is where doubt exists as to the stability of the labor and market conditions that will be present over the extended period of production, such as in the steel industry.⁸ An escalation contract may be either formally advertised or negotiated.

Fixed-Price Incentive Contracts. The fixed-price incentive contract is aimed, less at providing protection against unforeseen happenings, than at inducing the contractor to increase his efficiency and thus reduce his costs. Hence, the incentive provision areas may be contractor performance or end-item performance. There are two fixed-price incentive contracts being used: firm target and successive targets. A firm target type of contract has a target cost, negotiated at the outset, with a target profit, a price ceiling, and a formula for establishing final profit and price. This is commonly known as a share line. Thus, when the final cost is less than the target cost, the contractor will receive a portion of the saving as additional profit. A firm target contract is appropriate when negotiations, before contract award, can establish realistic targets that provide a fair and reasonably incentive.

With successive target contracts, the government and the prospective contractor negotiate at the outset an initial target cost, an initial

⁸Ibid, 3-404.3.

target profit, a price ceiling, a formula for establishing the firm target profit, and a point in production where the formula will be applied. This production point will normally be prior to delivery of the first unit. When this point is reached, the firm target cost is established and the firm target profit is determined by application of the formula. At this time, there are two alternatives possible. The contract may be converted to a firm fixed price type or another formula may be established for determining the final cost and profit. This will produce a firm target incentive contract with the final costs and profit to be determined at the conclusion of the contract. The successive target contract is appropriate when the knowledge of the probable costs at the outset is not complete enough to establish a fair firm target.⁹ All incentive type contracts must be placed by negotiation.

Fixed-Price Redeterminable Contracts. This type of contract includes a firm fixed price for a stated period of performance or deliveries and for prospective price redetermination either upward or downward at the proper points of time or deliveries during the life of the contract. Redetermination is usually used in procurements where adequate estimates of material and labor requirements are not initially known, the existing specifications are not accurate enough to establish a firm fixed price for the total life of the contract, or for any reason that a sound estimate of the costs cannot be reached. There are two types of redetermination that may be used:

1. Prospective Price Redetermination at a Stated Time or Times During Performance. This type of contract provides for a firm fixed price for an initial period of the contract deliveries or performance and for

⁹Ibid, 3-404.4.

a prospective price redetermination, either upward or downward, at a stated time or times during the life of the contract. It may also establish a ceiling price. It would normally be used where it is possible to negotiate a fair and reasonable firm fixed price for the first part of the contract, but not for the subsequent periods. This will arise from uncertainties concerning the rate at which the contractor can, and will, experience manufacturing efficiencies during the manufacturing process.

2. Retroactive Price Redetermination after Completion. This type of contract requires initial establishment of a price ceiling during the performance of the contract and for price redetermination at the time of completion. It provides no incentive at all, for control of costs. Because of this, it may be used only under the following conditions:

- a. The procurement is for research and development at an estimated price of \$100,000 or less.
- b. The contractor's accounting system is adequate for price redetermination.
- c. Reasonable assurance can be given that price redetermination action will be taken in a timely manner.
- d. A ceiling price is established.
- e. Written approval for its use has been received for a level of authority above the Head of the Procuring Activity.¹⁰

Under cost reimbursement contracts, which must all be negotiated, the government agrees to reimburse the contractor for all allowable costs that

¹⁰Ibid, 3-404.4.

are defined in ASPR Section XV. They are normally used in the absence of a proper basis for estimating performance costs with enough accuracy to permit the use of a fixed price type of contract. The original negotiations establish the estimates by which funds may be obligated and sets forth an estimated cost which the contractor may only exceed at his own risk.

Cost reimbursement contracts require a large administrative burden on both the government and the contractor and require extensive progressing and auditing of costs. The basic types of cost contracts are as follows:

Cost Contract. The cost contract is a cost-reimbursement contract in which the government pays no fee or profit to the contractor. It is normally used in research and development work with nonprofit educational institutions and organizations and also in facilities contracts.¹¹

Cost-Sharing Contract. In the cost-sharing contract, the government and the contractor agree upon a ratio by which the costs will be shared. For the contractors share of the costs, he expects to receive commercial benefits from his performance.¹²

Cost-Plus-Incentive-Fee Contract. The cost-plus-incentive-fee contract has a provision for a higher fee (profit), through application of a sharing formula, to be paid to the contractor when he performs at a cost lower than the original estimate. The initial negotiations will set a target cost and a target fee. They will also establish a sharing formula which may be based on cost, delivery, performance or all three of these areas. If the contractor is able to cut his cost below the

¹¹Ibid, 3-405.2.

¹²Ibid, 3-405.3.

original target, improve his delivery schedule, or exceed the target performance, he will receive a higher fee than the target. However, if he does not exceed the established goals, he will receive a lower fee than the target. This type of contract is used primarily for the development and test of major weapons and equipment, once the preliminary exploration has indicated a high probability that the development is feasible and the desired performance objectives of the government can be met. The range of the fee and the fee adjustment formula should be given the appropriate weight to provide the basic procurement objectives. In fact, the contract may provide for a minimum fee of zero or in some cases a negative fee.¹³

Cost-Plus-Award-Fee Contract. This type of contract is still experimental in form and concept. It has been approved by the ASPR committee to be used in "levels of effort" contracts. It would be applicable in such areas as operation and maintenance of facilities, programming services or research and development programs where the desired performance of the contractor is not precise enough to permit an incentive contract. It is superior to the Cost-Plus-A-Fixed Fee Contract in that it provides the incentive for a more effective effort and result. It specifies the contractor's performance is subject to evaluation by certain Navy personnel and a minimum fee and maximum possible award of fee is to be negotiated. The contractor's fee is then to be adjusted based on the evaluation of his performance. The procedure for evaluation and the criteria to be used are specified in the contract. The Navy's decision as to the proper amount of fee to be

¹³Assistant Secretary of Defense, Incentive Contracting Guide (Washington; 1963), p. 12.

paid is final and is not subject to the "Disputes" clause of the contract.¹⁴

Cost-Plus-a-Fixed-Fee Contract. The CPFF contract reimburses the contractor for all of his allowable costs and in addition, a fixed fee or profit that was negotiated at the inception of the contract. This fee will not vary with actual costs incurred. Because the fee does not vary, the contractor has only a minimum incentive to effectively control his costs. The CPFF contract may be used when the following conditions are met:

1. A cost-reimbursement type of contract is found necessary.
2. The contractor and government agree it should be fee bearing.
3. The contract is in the area of research and development, or preliminary exploration, where the level of effort required is unknown.
4. The contract is for development and test, where it would be impractical to use a CPIF contract. This type of contract is the least desirable of all.¹⁵

There are other contractual devices for special uses that will now be described:

Time and Materials Contract. This contract provides for the payment for supplies and services on the basis of the number of hours worked, at specified fixed hourly rate and for materials at cost price. The fixed hourly rate allows for direct and indirect labor, overhead and profit. The time and materials contract is used only where it is not possible, at the time of contract award, to estimate the duration

¹⁴Office of Management Information, Navy Management Review (Washington, March, 1963), p. 25.

¹⁵Armed Services Procurement Regulation 3-405.5 (Washington: Government Printing Office, 1949).

or extent of the work to be performed, or to estimate the costs to be incurred. Careful management of this type of contract is necessary since it does not have an incentive for effective control of costs. In addition, it should only be used when it has been positively established that no other type of contract will suitably serve. It is normally used in areas such as, engineering, and design services in connection with the production of supplies, the engineering, design, and manufacture of jigs, dies and other special tools and repair, maintenance or overhaul work.¹⁶

Labor-Hour Contract. This is a variant of the time and materials contract, and is exactly the same except that no materials are supplies by the contractor. Its uses and limitations are exactly the same as the time and material type contract.¹⁷

Letter Contract. The letter contract is a written, preliminary document, used to give the contractor permission to immediately begin work. It may be entered into when:

1. It is in the best interest of national defense.
2. Negotiation of a definitive contract may not be completed in sufficient time to meet the procurement delivery schedule.

It may be used only after a written determination has been made that no other type of contract is suitable. In addition, it is necessary to insure a definitive contract has been written within 180 days from the date of the letter contract, or when 40% of the production of the supplies or work performance has been completed. Whichever of the above conditions occurs first, will be the governing factor. The maximum

¹⁶Ibid, 3-406.1.

¹⁷Ibid, 3-406.2.

liability to the government shall not exceed fifty percent of the total estimated cost.¹⁸

The final contracts to be described are the indefinite delivery types. These are used primarily where the exact time of delivery is not known at the time of contracting.

Definite Quantity Contracts. This provides for delivery of a specified amount of material or services within a given period of time, at designated location, upon the request of the government. It is normally used where it is known, in advance that a definite quantity of specified supplies will be required, at known destinations, within a given period of time.

Requirements Contract. A contract of this type requires the contractor to supply the requirements, of designated activities, for specified supplies or services, as orders are placed, during a specified period. An excellent example of the requirements contract would be milk and bread supplies to a station general mess.

Indefinite Quantity Contract. This is quite similar to the definite contract, except there is no specified quantity stated in the contract. There is a maximum and minimum established on the amount that can be ordered at any one time and also the total quantity. The indefinite quantity contract is used where it is impossible to predict the quantities that will be needed, by designated activities, and the government cannot commit itself to more than the minimum. An example would be a contract for the movement of household effects.¹⁹

¹⁸Ibid, 3-408.

¹⁹Ibid, 3-409.

While it is not a contract, a basic agreement might well be defined here. It is a written understanding that certain designated clauses, usually negotiated for each individual contract, will be incorporated in future negotiated contracts placed with the contractor. It will normally be used when it is anticipated that many contracts will be placed with the contractor and there will be substantial recurring negotiation problems.²⁰

With the conclusion of the description of the various types of contracts, I shall now describe the first method of procurement, formal advertising.

²⁰Ibid, 3-410.

III

FORMAL ADVERTISING

Within government procurement, formal advertising is the most basic and preferred method for the purchase of supplies and services. Procurement by our other method, negotiation, is permitted only under specifically described circumstances. These will be described in detail in Chapter IV.

Formal advertising was first put into law more than a hundred years ago, in 1861. It was a result of pressure placed on Congressmen by their constituents to secure more contracts and from the belief that awards were not being made impartially. Although Congress has not changed on its insistence in the use of formal advertising, it has come to realize in our complex age that procurement of weapons systems, missiles and aircraft can only be accomplished by negotiation.

To make formal advertising a powerful tool for use by the procurement team, the following conditions must be met:

1. The specifications to be used in the procurement process must, in all cases, be clear and explicit to positively identify the material being purchased.
2. The specifications must be available to all prospective bidders.
3. There must be, at least, two known suppliers who are able and willing to compete for award of the contract.
4. The award of the contract is to be made on price alone, to the lowest responsive, responsible contractor.
5. There must be sufficient time available to permit the required procedures for preparing, making distribution of the bids to the pros-

pective contractors, receiving, opening and evaluating the bids, and finally, award of the contract.²¹

This method of procurement involves a series of individual steps. The requirement must be well defined as to the preparation and distributing of invitations to bid, submission of bids, opening of bids, and award of the contract. There is no requirement for advertising a proposed procurement action in periodicals or newspapers. It is, however, necessary to publicize any action which might be awarded in excess of \$10,000, in the Commerce Business Daily. "Synopsis of U. S. Government Proposed Procurement, Sales and Contract Awards".²² This procedure was designed to provide the benefits of open competition for such materials as the government requires. In addition, in conformance with the wishes of Congress, it gives all qualified sources of supply an equal chance to receive government contracts. There are only two types of contracts that may be awarded by formal advertising, firm fixed-price and fixed price with escalation.

The invitation for bid is prepared on the Standard Form 30. The bid will contain the office to which the bid should be submitted, the date and hour that the bids will be publically opened and a listing of the terms and conditions under which the contract will be awarded.

The Standard Form 33 may also be used in the preparation of the invitation for bid. The essential difference between the forms is the space available on the form 33 for acceptance and award of the contract. If the form 30 is used, the award is made on the Standard Form 26.

²¹Armed Services Procurement Regulation 3-404.2 (Washington: Government Printing Office, 1949).

²²Ibid, 1-1003.1

Bids are normally solicited on the basis of a complete set of specifications. The specifications are a statement of the minimum needs of the government and must be written in such a manner as to permit bidders to compete on a common basis. They cannot be unduly restrictive as this will eliminate competition.²³ If the desired material is not covered by a specification, and the preparation of a specification is not justified due to time or other considerations, the bid may be based on a purchase description which contains all of the essential characteristics of the item being purchased. If it is not possible to formulate a detailed description in time for a proposed procurement, the brand name of a commercial item may be used together with the words "or equal".²⁴ The bidder may offer an article that will be equal in all respects. The specifications for the ensuing contract will then be the specifications of the article that has been accepted by the government as an equal.²⁵

Invitations for bid are distributed to prospective contractors in a number of ways. The contracting office maintains a list of bidders by commodity and will mail the invitations to the appropriate suppliers. This list is compiled from review of telephone directories, travel journals, Standard and Poor, Dun and Bradstreet and direct request for inclusion by a contractor. A request for inclusion on the list is made on

²³39 Comptroller General 101, (Washington, 1959).

²⁴Armed Services Procurement Regulation 1-1206 (Washington: Government Printing Office, 1949).

²⁵Armed Services Board of Contract Appeals, number 587 Government Printing Office, (Washington, 1951).

a Bidder's Mailing List Application Form that is available at the procurement office. The application requires the prospective bidder to submit certain information, such as financial status, products manufactured, and organization structure, that may be analyzed by the contracting officer. If satisfactory, the supplier will then be placed on the list. Any contractor on the debarred or suspended list will not be included in a solicitation. A bidder who does not respond to an invitation may also be removed from the list, unless he notifies the contracting officer of his continued interest in future procurement actions. The contracting officer is required to solicit sufficient bidders, who are qualified, to insure full and free competition.²⁶ In addition, copies of the invitation are available at the purchasing office and may be given to prospective new bidders.

Solicitation must be made in sufficient time to permit the supplier to review the specifications, prepare his bid, and submit the bid in time for the opening.²⁷ The usual time for an invitation to be "on the street" is thirty days. Shorter times may be used, but it should never be less than fifteen days except during an emergency.

The contracting officer must insure equal treatment to all bidders. Any information furnished to one prospective bidder must be made available to all bidders. If necessary, it should be in the form of an amendment to the invitation. To insure equal competition, the invitation should not include any conditions or restrictions that would give an

²⁶Armed Services Procurement Regulation 2-205 (Washington: Government Printing Office, 1949).

²⁷Ibid, 2-202.

advantage to one bidder.²⁸ To provide an opportunity for additional bidders, the distribution of the invitation for bid may not be limited to past known producers of an item. It is possible though, to establish a set of minimum qualifications which the bidder must possess to be considered for award.²⁹ An example of this would be the Qualified Products List.

During the preparation of his bid the contractor should take several conditions under consideration.

1. Price. The bidder must normally include the unit price as well as the total extended price. If applicable, the price should include all charges for packing and transportation. Any discount offered by the bidder will be taken into account at the time the evaluation is made. This is, of course, provided the discount period is within those prescribed in normal business practice.

2. Quantity. Unless specified in the invitation, the bidder may offer a smaller quantity than is required. In this way a small business may be awarded a portion of the requirement. It must also be borne in mind, the government reserves the right to award a quantity that is less than the quantity offered by the bidder.

3. Transportation and Delivery Terms. Bids are evaluated on the basis of total cost to the government. The invitation will specify the terms and conditions of the delivery of the supplies. This will indicate if acceptance by the government will be at origin or destination. In most cases, if the destination is known, the invitation will request

²⁸17 Comptroller General 37, (Washington, 1937).

²⁹36 Comptroller General 42, (Washington, 1956).

bids on a delivered price to the destination. The cost with transportation included is the basis for bid evaluation.³⁰

While preparing their bids, contractors must ensure they conform to all the requirements of the terms and conditions set forth in the invitation for bid. The forms supplied by the contracting office should be used in all cases, unless, the invitation permits alternate submissions. For example, a submission of a telegraphic bid may not be accepted, unless it is authorized in the original solicitation. Bidders should insure the bid has been prepared carefully, as a small mistake may render their bid nonresponsive. All work sheets or estimates used in the preparation of the bid to be submitted should be retained. In that way, the prospective contractor will have evidence to support any mistake that may be discovered after the bids have been opened. Suppliers should ensure the bids are placed in the mails or the bid box at the purchasing activity in ample time to permit receipt prior to the scheduled opening of the bids. A bid that is received late may only be considered if the evidence indicates the supplier allowed ample time for mailing.³¹

In order to avoid any charge that bids have been changed or altered, all bids are placed in a locked safe immediately upon receipt. This is commonly known as a "bid box". At the time specified in the invitation for opening, the contracting officer will open and publicly read all bids that have been received. This takes place at a public hearing, at which,

³⁰Gilbert, A. Cuneo, Government Contracts Handbook, Machinery and Allied Products Institute and Council for Technological Advancement, (Washington, 1964), p. 16.

³¹Armed Services Procurement Regulation 2-303, (Washington: Government Printing Office, 1949).

all prospective suppliers may be present. The contracting officer will then record all bids on an abstract. This, together with a duplicate copy of each offerer's bid, will be made available for inspection by the public.³² Any information, submitted by the bidder, that is proprietary in nature may be excluded from public review if so marked.

Until the time of opening, a bidder may modify or withdraw it by giving written or telegraphic notice to the contracting officer. A telephone call will not suffice. If written notice is received after bid opening, it must be handled in the same manner as a late bid. One exception to this being, if the modification is in no way prejudicial to other bidders and in the best interest of the government. An example of this would be a bidder who submits a late modification to his bid that reduces the unit price of the supplies, when in fact, he is the low bidder at the time of opening. If a contractor is not in agreement with the contracting officer's decision as to the matter of bid withdrawal, he may appeal the decision to the Comptroller General.

The contracting officer must carefully examine each bid received to ascertain if it is responsive to the invitation. The award must be made to the responsible bidder; whose responsive bid will be the most advantageous to the government, price and other factors considered.³³

A bid does not conform to the invitation if the bidder has posed any qualifications to the essential requirements. Any major deviations to the requirements may not be waived or changed after the opening of

³²13 Comptroller General 471, (Washington, 1934).

³³Gilbert A. Cuneo, Government Contracts Handbook, Machinery and Allied Products Institute and Council for Technological Advancement, (Washington, 1964), p. 17.

the bid. A major deviation is one that affects the price, quantity or quality of the required product.³⁴ If the invitation indicates that time of delivery will be a salient factor in consideration for award, a bid that does not conform to the delivery schedule will be considered nonresponsive.³⁵ Likewise, if a bidder submits two or more bids in a manner to "bracket" other bidders, his bids may be rejected by the contracting officer. An unsigned bid should also be rejected.

In cases known as a "minor informality", such as status of the bidder as a manufacturer or producer, failure to furnish descriptive data, or to affix a corporate seal, may be corrected by allowing the bidder to furnish the information prior to the award of the contract.³⁶ Whether a defect is considered major or minor will depend on what is in the best interests of the government, provided it is not prejudicial to any of the other bidders.

The procurement statutes authorize the heads of departments or agencies to reject all bids, when it is in the best interests of the government. This may be done when the contracting officer certifies, in writing, that the material is no longer required; all bids are unreasonable as to price; the specifications should be modified; or the invitation does not provide for consideration of all factors of cost. After opening, the invitations are known to the public. Any cancellation and later readvertising may be prejudicial to the bidders, especially the low

³⁴33 Comptroller General 508, (Washington, 1954).

³⁵Armed Services Procurement Regulation 2-404, (Washington: Government Printing Office, 1949).

³⁶Ibid, 2-405.

bidder, and should be avoided except where the need is compelling.³⁷

The proper procedure for formal advertising requires that the bids be approved as submitted. It is, therefore, of the utmost importance that care be taken in their preparation. It becomes necessary, each year, for the Comptroller General to rule on many cases of an alleged mistake in bid.

A mistake in bid prior to opening may easily be corrected by either modification or withdrawal of the bid. However, after opening, the procedure to correct a mistake becomes much more difficult. When a mistake in bid is discovered after opening, by either the prospective contractor or the government, two rules apply, if prior to award. An obvious error, such as a clerical mistake, may be corrected by the contracting officer after the bidder has submitted evidence to support the intent of the bid. An error of any other type discovered, prior to award, must be submitted to the General Accounting Office for decision. Evidence submitted to support the alleged mistake must be clear and convincing as to the nature of the mistake and the intent of the bidder.³⁸

When a mistake is discovered after the award of a contract, it may only be corrected by the General Accounting Office, unless it has delegated this authority to certain agencies. By this delegation the agency heads may revoke a contract that does not exceed \$1,000, or rewrite a contract which results in an increase or decrease in price does

³⁷Armed Services Procurement Regulation 2-404, (Washington: Government Printing Office, 1949).

³⁸Armed Services Procurement Regulation 2-406, (Washington: Government Printing Office, 1949).

not exceed that of the next low bidder. This authority may only be used where it is obvious that; a mistake in bid was made; the mistake was mutual or should have been noted by the contracting officer prior to award; and the contract price should be increased or cancelled.

An any time a contracting officer suspects a mistake in bid, he must ask the bidder to confirm his intent. A contracting officer, who knows of a mistake before award is made, cannot accept a bid as a valid contract.³⁹

When the contracting officer asks a contractor to confirm his bid, it will usually be in a case where contracting personnel strongly suspect a mistake. Again here, if a bidder is requested to submit evidence in support of a mistake and has saved his work sheets, he will then be in an excellent position to support his claim. A contracting officer may not accept a bid that contains an obviously erroneous price even though the bidder confirms his price.⁴⁰

In summary, the military departments have the following types of authority concerning an alleged mistake in bid:

1. When a bidder requests withdrawal of a bid in which clear evidence has been submitted to support the claim, a determination may be made to permit the withdrawal of the bid.
2. However, if the evidence as submitted, indicates the bidder would still be low in his price, a decision should be made to allow correction but not withdrawal.
3. When a bidder requests permission to correct a bid, permission

³⁹Ibid.

⁴⁰Ibid.

should only be given if the corrected price does not displace any other bidder.

4. If the evidence is not clear that the bid as originally submitted was not the intended bid, a determination may be made to consider the bid in its present form.⁴¹

The Armed Services Procurement Act of 1947 provides that:

Awards shall be made with reasonable promptness by giving written notice to the responsible bidder whose bid conforms to the invitation and will be the most advantageous to the United States, price and other factors considered....

The contracting officer must make a positive determination as to the responsibility of the contractor. Responsibility is normally based on the following considerations:

1. The bidder is a manufacturer or regular dealer in the supplies to be furnished.
2. The bidder has adequate financial resources or a way to secure such resources.
3. The bidder is able to comply with the required delivery schedule of the contract.
4. The bidder has a past history of satisfactory performance under government contracts.
5. Will conform to the requirements of the nondiscrimination clause.
6. He is otherwise eligible to receive the award under existing laws.⁴²

⁴¹Ibid, 2-406.3

⁴²Gilbert A. Cuneo, Government Contracts Handbook, Machinery and Allied Products Institute and Council for Technological Advancement, (Washington, 1964), p. 21.

A "pre-award" survey, by the applicable Inspector of Naval Material, may be used in cases where there is doubt in the mind of the contracting officer. In addition, if the prospective contractor is a small business, it may be necessary to receive a Certificate of Capacity and Credit from the Small Business Administration, to establish his performance responsibility.

In a case where equal bids are received, awards will be made in the following order of preference:

1. A small business concern who will perform in a persistent labor surplus area.
2. Any concern who will perform in a persistent labor surplus area.
3. A small business concern who will perform in a substantial labor surplus area.
4. Any concern who will perform in a substantial labor surplus area.
5. Any small business concern.
6. If two or more bidders are still eligible for award, it shall be made to the bidder who will make the most extensive use of small business subcontractors.
7. If this cannot be established, award will be made by a drawing of lot.⁴³

To further clarify, the Labor Department has defined a persistent labor surplus area as one where:

1. Current unemployment is at least six percent of the total labor force.

⁴³Armed Services Procurement Regulation 2-407.6, (Washington: Government Printing Office, 1949).

2. The annual average unemployment rate has been at least fifty percent above the national unemployment average during three of the last four years, 75 percent above the average for two of the last three years, or 100 percent above the average for one of the past two years.

If the same degree of preference applies to two or more equal bidders, based on the above, it has been normal practice to award the contractors by lot.

When the invitation for bid calls for a number of items, an award may be made to the lowest bidder on each item, where the saving on the award of multiple contracts will offset the additional administrative cost.⁴⁴

A bidder will normally condition his bid as to acceptance within a stated period of time. He shall be released from his bid unless award is made by the expiration of the time. The bidder may, if he desires, extend the period of acceptance.

At any time a bidder feels that the contracting officer is not acting within the constraints of the published statutes, he may submit a formal protest of the action or the award of a contract. The protest must be accompanied by a complete statement of facts to support the claim. It should be submitted to the Comptroller General via the contracting officer. The contracting officer will expeditiously prepare a "statement of fact" to accompany the protest. If the contract has not been awarded, all action should be suspended until such time as the Comptroller has made a ruling.⁴⁵ If award of the contract has been made, the decision

⁴⁴33 Comptroller General 555, (Washington, 1954).

⁴⁵Armed Services Procurement Regulation 2-407.9, (Washington: Government Printing Office, 1949).

of the Comptroller will determine if the award is to be cancelled or permitted to stand.

Two-Step Formal Advertising was developed by the Air Force upon the recommendation of the House Armed Services Committee. Upon approval, it was incorporated in ASPR. It is used to increase formal advertising in technical buys, where the existing specifications are indefinite enough to require negotiation between the suppliers and procurement personnel.

Step one is a request for technical proposals based on a performance specification that describes the desired results of the contract. During this step, there is no mention of price. The procuring activity, with the aid of the cognizant technical personnel, determine which of the proposals is satisfactory. If necessary, the contracting officer may give suppliers of marginal proposals an additional opportunity to qualify.

Step two requests all prospective contractors, who submitted acceptable proposals, to submit bids as under normal formal advertising. The resulting supplies or services offered by the bidder must conform to the specifications and his technical proposal as accepted by the government.⁴⁶

This concluded the topic of formal advertising and now I shall present contracting by negotiation.

⁴⁶Ibid, 2-501.

IV

NEGOTIATION

The Armed Services Procurement Act of 1947, with the applicable 10 U.S.C. 2304, permits the use of negotiation in seventeen instances. Because the authority to negotiate is permissive, departments may continue to procure by formal advertising in whole or in part. It should be remembered, the ASPR requires the use of formal advertising where either advertising or negotiation is possible.

As mentioned, negotiation may be used in seventeen instances:

1. It is determined that such action is necessary in the public interest during a national emergency declared by Congress or the President.⁴⁷

During a period of emergency, the placing of contracts by formal advertising might be inconsistent with the needs of the nation. The necessary speed and broadening of the industrial base of suppliers required, can only be accomplished by means of negotiation. The use of this authority has been administratively restricted to the following types of procurements: labor surplus or disaster area types of programs; and unilateral set-asides in the small business program. It should be pointed out that no award for a labor set-aside may be made at a price higher than that of the nonset-aside portion.⁴⁸

2. The public exigency will not permit the delay incident to advertising.⁴⁹

⁴⁷Armed Services Procurement Regulation 3-201, (Washington: Government Printing Office, 1949).

⁴⁸40 Comptroller General 489, (Washington, 1961).

⁴⁹Armed Services Procurement Regulation 3-202, (Washington: Government Printing Office, 1949).

This authority may be used where conditions are such as to cause the government to be seriously injured, financially or otherwise, if the required material were not furnished by a certain date, and procurement by formal advertising would not permit this date to be met. It is used when fire, flood, explosion or other disaster create an immediate need for supplies. It is also used when material for essential equipment for ships or aircraft is needed, at once, for the performance of assigned missions.

3. The aggregate amount involved is not more than \$2,500.⁵⁰

In this area, procurement by negotiation may be used provided the aggregate amount of the purchase does not exceed \$2,500. It is essential, in using this authority, that procurements not be broken down into several purchases that are less than \$2,500. The total requirement must be considered at all times.

4. The purchase or contract is for personal or professional services.⁵¹

This is permitted, when the services are performed by an individual contractor or, if professional services, when performed by a firm or organization. The services must be of a technical nature or performed under government supervision and paid for on a time basis. This exception is not permitted if any other method of securing the services is available.

5. The purchase or contract is for any service by a university, college, or other educational institution.⁵²

⁵⁰Ibid, 3-203.

⁵¹Ibid, 3-204.

⁵²Ibid, 3-205.

The use of this exception is to permit the military departments to obtain services for research purposes and for training of personnel at the applicable institution.

6. The purchase or contract is for property or services to be procured and used outside the United States, its Territories, its possessions, and Puerto Rico.⁵³

Where applicable, this exception is used in preference to all others and formal advertising should not be considered.

7. The purchase or contract is for medicine or medical supplies.⁵⁴

This exception is restricted to procurements of such supplies as are peculiar to the field of medicine, such as x-ray equipment, surgical instruments, orthopedic supplies but not prosthetic equipment. Procurements, under this exception, should be given advance publicity for a period of at least fifteen days if it is expected the contract will exceed \$10,000.

8. The purchase or contract is for property for authorized resale.⁵⁵

By regulation, this exception shall be used for purchases of products with a brand name or of a proprietary nature. The products are then offered for resale at such activities as exchanges or commissaries. The requirements of this exception should also be publicized in the same manner as medical supplies.

9. The purchase or contract is for perishable or non-perishable subsistence supplies.⁵⁶

⁵³Ibid, 3-206.

⁵⁴Ibid, 3-207.

⁵⁵Ibid, 3-208.

⁵⁶Ibid, 3-209.

The military departments may purchase all types of perishable or non-perishable supplies under this exception. It must be remembered that only a few days delay in the marketing of such commodities as lettuce, bread, or tomatoes would greatly affect their freshness. Thus, the speed of negotiation must be employed.

10. The purchase or contract is for property or service for which it is impracticable to obtain competition.⁵⁷

This exception applies when material or services can only be obtained from one source of supply. It may be used when the required items are covered by copyrights, patent rights, secret processes or if no responsive bid is received after formal advertising. In cases where it is impossible to draft adequate specifications for use in an Invitation for Bids, this exception has been effectively employed to secure the desired material. Care should be taken to insure the proper data or specifications are received to preclude the necessity for future procurements on a "sole source" basis.

11. The purchase or contract is for property or services whose procurement that he (the Secretary) determines to be for experimental, developmental, or research work, or for making or furnishing property for experiment, test, development, or research.⁵⁸

Procurements negotiated under this authority relate to theoretical analysis, exploratory studies, and experimentation in any field of science or technology. Also, in the case of developmental contracts requiring practical application of investigative finding and theories of a scientific or technical nature; or purchases of such quantities of a particular item to permit experimentation, research or test; or services, tests, and applicable

⁵⁷Ibid, 3-210.

⁵⁸Ibid, 3-211.

reports on experimental, developmental, or research work may be procured in this manner. This authority does not extend to educational institutions or for quantity production. Research and development contracts which call for the production of several experimental or test models are not regarded as contracts for quantity production.

12. The purchase or contract is for property or services whose procurement he (the Secretary) determines should not be publicly disclosed, because of their character, ingredients, or components.⁵⁹

Buys under this exception are classified for security reasons as "confidential" or above, or where it is in the best interests of the government not to disclose the contents of the contract. This exception does not preclude the procurement of classified material by formal advertising, if publicity is not a governing factor.

13. The purchase or contract is for equipment that he (the Secretary) determines to be technical equipment whose standardization and the interchangeability of whose parts are necessary in the public interest and whose procurement by negotiation is necessary to assure standardization and interchangeability.⁶⁰

Some examples of this exception may be found in places that require a limitation to the quantity and variety of spare parts to be carried, or to make it possible, by standardization, the availability of parts that may be interchanged from items damaged in combat or other emergencies. It is necessary for a current or recurring procurement to exist at the time procurement action is taken.

14. The purchase or contract is for technical or special property that he (the Secretary) determines to require a substantial initial investment or an extended period

⁵⁹Ibid, 3-212.

⁶⁰Ibid, 3-213.

of preparation for manufacture, and for which he determines that formal advertising and competitive bidding might require duplication of investment or preparation already made or would unduly delay the procurement of that property.⁶¹

This authority was originally designed for sole source procurements, but has been expanded to include procurements with more than one source of supply. It is used for the purchase of technical or specialized supplies, such as missiles, radar or other major components, or for supplies of a technical nature which may be used to support major equipments. These purchases involve a very high starting cost which have already been paid for by the government or the contractor. In addition, preliminary engineering, special tooling and substantial time and effort have been expended by the prospective contractors. This exception does not preclude competition, but limits the competition to suppliers who are qualified.

15. The purchase or contract is for property or services for which he (the Secretary) determines that the bid prices received after formal advertising are unreasonable as to all or part of the requirements, or were not independently reached in open competition, and for which (A) he has notified each responsible bidder of intention to negotiate and given him a reasonable opportunity to negotiate; (B) the negotiated price is lower than the lowest rejected bid of any responsible bidder, as determined by the head of the agency; and (C) the negotiated price is the lowest negotiated price offered by any responsible supplier.⁶²

This exception may be used to protect the government in situations where formal advertising is used first, but produces excessive or collusive bids. In either of these situations, the only effective course of action available to the contracting officer, is to negotiate with one or more of the bidders

⁶¹Ibid, 3-214.

⁶²Ibid, 3-215.

in an effort to establish a reasonable price and thereby obtain the desired supplies. If there is any evidence of collusion, the matter should be reported immediately to the Justice Department.

16. He (the Secretary) determines that (A) it is in the interest of national defense to have a plant, mine, or other facility, or, a producer, manufacturer, or other supplier, available for furnishing property or services in case of a national emergency; or (B) the interest of industrial mobilization in case of such an emergency, or the interest of national defense in maintaining active engineering, research, and development, would otherwise be subserved.⁶³

This negotiation authority is used to effect procurements when mobilization planning considerations require the continued operation or availability of the facilities of selected producers. It may also be used for the training of contractors in production of critical items that would be necessary in a time of emergency and to maintain properly balanced sources of supply for meeting the procurement programs in the interest of industrial mobilization.

17. Negotiation of the purchase or contract is otherwise authorized by law.⁶⁴

This exception was authorized by Congress to preserve and implement statutory authority to negotiate contracts contained in legislation other than the Armed Services Procurement Act. It is used substantially with other governmental departments such as a joint determination of a small business set aside with the Small Business Administration.

A negotiated procurement may vary in price from two dollars to many millions of dollars. They are distinctly distinguished from purchases by formal advertising. Negotiation permits a greater flexibility of

⁶³Ibid, 3-216.

⁶⁴Ibid, 3-217.

action in the procurement process than does the strict, rigid area of formal advertising.

A contracting officer, upon determining that a negotiated type of procurement is applicable, must prepare a Determination and Finding. This document may be signed by the contracting officer, except for exceptions 11 through 16 of the U.S.C. 2304. In those areas it is necessary for the D. & F. to be signed by the Secretary of the Department.

The contracting officer must locate sources of supply in the same manner as in formal advertising. The solicitation may be accomplished by telephone, telegraphy or by formal Requests for Proposals (RFP) or Requests for Quotation (RFQ). The contracting officer will solicit proposals or quotations from as many known suppliers as is necessary to insure free competition, and thus secure the best product for the lowest cost.

All records of a negotiated procurement are kept confidential, which enables the procuring activity to open each proposal upon receipt. In this manner, it is possible to evaluate all proposals, much as in formal advertising, in an expeditious manner. It is possible in negotiation, though, to contact the prospective supplier in any areas of the proposal that may be questionable.

Careful consideration must be given to the type of contract chosen. As explained in Chapter II, the fixed price contract is the most advantageous to the government, since it places all of the risk on the contractor. In many cases, it is necessary to secure a cost type contract since the work may be R. & D. or the specifications not definitive. It is imperative to secure the type of contract which places the least risk

on the government.

Although the negotiator and contracting officer have the primary responsibility for evaluating the proposals, the requiring activity must also provide assistance in the technical areas of the procurement request. In addition, the Weighted Guidelines Method for the establishment of profits is used in all cases where profit is negotiated.⁶⁵ As in the case of formal advertising, a procurement solicitation or award must be published in the Department of Commerce, Business Daily.

Care must be taken during the negotiation period to insure each suppliers proposal is held in strict confidence. At no time may the proposal or accompanying data, be made known to the public. Through the use of good negotiation techniques, the contractor may be requested to make modifications to his proposal in the areas of both price and material. In this manner, through the use of a team effort in price evaluation, technical review, cost analysis and legality a beneficial contract may be negotiated for the government.

In summary, negotiation does not mean sole source and in numerous cases, due to its flexibility, can provide the government with a more beneficial contract than is possible under formal advertising.

⁶⁵Ibid, 3-808.2

CONCLUSIONS

The remarks made by Rear Admiral B. H. Bieri, Jr., SC, USN, during a recent address is an excellent summary as to Navy's procurement position in today's complex world.

In contemplating the function of naval procurement it is important first of all to view it in its proper and broadest national perspective.

We are, of course, concerned with getting the best possible weapons systems for our operating forces at sea and at the lowest possible prices. These are prime considerations in all our procurement actions.

But there is also a deeper, more fundamental aspect of our programs which we must keep constantly in mind.

It is essential that we remain always aware of the impact of Defense spending upon the American industrial community. This concerns not merely the huge sums of money that are involved but more importantly the basic relationship between the government and its commercial suppliers.

The United States has grown strong under a capitalistic, highly competitive, individual private enterprise system.

Our aim in procurement is to strengthen that system as we perform our buying functions and to reinforce the concept of a freely operating market system.

It is vitally important, therefore that we inject into our contractual relationships with private companies the same concepts which operate naturally and automatically in a free enterprise system.

That is why we emphasize competition among our suppliers. This is why we encourage the private assumption of financial risks. This is why we generate incentives wherein rewards and penalties are clear and certain, just as they are in the normal market place.

With these thoughts in mind, I believe it is quite proper to conclude that, both formal advertising, in a limited area, and negotiation have

a valid place in government procurement. In many cases, formal advertising is forced on the procurement team. This is required, either to maintain the proper statistics for a given office, or for lack of a definitive need for negotiation. The final result of the action produces an inferior product and additional overall costs to the government in the area of maintenance, repair and replacement. This has been evident in such areas as materials handling equipment. Racks and pallets have been produced by formal advertising and the results have been unsatisfactory. The material received will not provide the government with equipment that is substantial in nature. With formal advertising, a man with an ax and a tree in his back yard may bid on a Navy pallet contract.

Formal advertising stresses only the minimum need at the lowest cost. It is a well known fact, that in private industry there is no formal advertising performed. The reason is quite clear, the policy is to maximize the gain for each dollar expended, not to blindly accept the lowest cost in each case. For the purchase of standard or commercial items, formal advertising does have some advantages. A commercial item that is sitting on a contractor's shelf and is not covered by military specifications would be quite applicable. Here we are only interested in who will supply the item at the lowest cost, but even then an error or omission on the part of the bidder will cause disqualification as non-responsive. Again here, the government costs will be increased.

The focal point of action is to convince the Congress that negotiation does not mean only sole source procurement. Although this fact has been presented on numerous occasions at committee hearings, the feeling still persists, in Congress, that negotiation is an evil that

must, in some cases, be lived with. If Congress is convinced, that in the long run, negotiation will provide the most for the government at the lowest cost, it will be possible to expand the now existing exceptions into all areas with the exception of a standard commercial item that is bought off the shelf. Most of the cases that are referred to the Comptroller General as a result of a protest are in the field of formal advertising. This again is due to the rigidity that governs all procurements by this method. Also the administrative costs for the processing of the protest continue to rise, a fact not shown in the contract price.

The award of a contract at a certain price does not insure that it will be the total overall cost to the government. A product that requires additional maintenance, has a shorter life, or possibly is not even delivered will only increase the cost of the buy. It is true a defaulted contract is repurchased against the account of the contractor, however, the cost of the Navy not having the material when it is required may be more than double or triple the contract price.

There is extreme flexibility in the conduct of negotiations that does not exist in formal advertising. First, a cost analysis and audit may be made of the proposals that have been submitted. Second, discussions are possible with all known sources of supply. Third, modifications as to price or product are possible based on the discussions. Fourth, advances in the state of the art may be possible to incorporate within the contract. Fifth, more effective use may be made of the entire procurement system. All of the above principles lead to the government, with is the taxpayer, receiving the maximum benefit for each procurement dollar spent.

A partial solution to the situation is that of two step formal advertising. This provides some of the flexibility of negotiation during step one. The main disadvantages of this type of action are: (1) The additional time that is required to award the contract, and (2) Non-qualified suppliers are apt to protest the decision which will also delay the award.

With these thoughts in mind, I believe that contracting by negotiation is the most efficient and effective method available to government personnel. Properly controlled, it will continue to advance our worldly position and provide the finest supplies and materials at the lowest total cost.

Appendix I sets forth seven tables that provide a complete review of government procurement during the past several years. It is evident that the product mix is changing, more emphasis is being given to small business, and except during periods of war, government procurement has been steadily increasing at approximately three percent per year. Our era is one in which a slight mistake may prove to be the destruction of the world. Through careful and competitive procurement practices to provide our military machine with the best equipment and supplies, this mistake may be avoided.

APPENDIX I

TABLE I

TOTAL DOD CONTRACT AWARDS
(in billions)

<u>FY</u>	<u>\$</u>	<u>FY</u>	<u>\$</u>	<u>FY</u>	<u>\$</u>
'52	\$43.6	'57	\$21.5	'62	\$29.3
'53	31.8	'58	24.2	'63	29.4
'54	13.3	'59	25.3	'64	28.8
'55	16.6	'60	23.7		
'56	19.9	'61	25.6		

TABLE II
DOD CONTRACT AWARDS BY PROCUREMENT
PROGRAM INCLUDING R & D - FOR FY 1964

<u>Program</u>	<u>Total*</u>	<u>R & D</u>
Major Hard Goods		
Aircraft	\$ 6,067	\$ 641
Missiles	5,579	3,112
Ships	1,485	142
Tank - Automotive	745	22
Weapons	211	40
Ammunition	661	76
Electronics	<u>2,918</u>	<u>648</u>
Subtotal	\$17,666	\$4,681
Services	1,800	409
All Other		
Subsistence	580	--
Textiles, Clothing	262	1
Fuels and Lubs	788	1
Miscellaneous Hard Goods	1,054	32
Construction	1,360	1
Less than \$10,000	<u>2,710</u>	<u>18</u>
Subtotal	\$ 6,754	\$ 53

*Includes R & D

TABLE III
COMPARISON OF DOD CONTRACT
AWARDS IN THREE ERAS

<u>Program</u>	(percentages)		
	<u>WW II</u>	<u>Korea</u>	<u>FY'61</u>
Aircraft	27.3	31.5	28.2
Missiles	0.0	0.5	33.6
Ships	26.2	6.8	7.8
Electronics	6.6	11.2	18.0
Tank - Automobile & Other	<u>39.9</u>	<u>50.0</u>	<u>12.4</u>
	100.0	100.0	100.0

TABLE IV

ANALYSIS OF 100 COMPANIES

RECEIVING LARGEST DOLLAR VOLUME

OF DOD AWARDS IN FY 1959-1963

<u>Companies</u>	(percent of total contract \$'s)				
	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
Top 5	25.0	24.8	24.8	22.5	23.2
Top 25	54.6	53.5	54.8	50.8	51.9
Top 100	73.8	73.4	74.2	72.3	73.9

TABLE V
TEN CONTRACTORS WITH LARGEST SHARE
OF NAVY PROCUREMENT DOLLARS
IN FISCAL YEAR 1964

	<u>Millions</u>	<u>%</u>
McDonnell Aircraft Corporation	\$1,127	12.5
Lockheed Aircraft Corporation	589	6.6
United Aircraft Corporation	488	5.4
Newport News Shipbuilding and Drydock Company	400	4.4
Grumman Aircraft Engineering Corporation	392	4.4
North American Aviation Inc.	323	3.6
General Dynamics Corporation	320	3.6
Sperry Rand Corporation	207	2.3
Westinghouse Electric Corporation	199	2.2
General Electric Company	<u>182</u>	<u>2.0</u>
	\$4,228	47.0

FY 1964

TABLE VI
PERCENT DISTRIBUTION OF DOD PRIME CONTRACT
AWARDS TO SMALL BUSINESS

<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>
17.1	16.6	16.1	15.9	17.7	15.8	17.2

TABLE VII⁶⁶

DOD PRIME CONTRACT AWARDS
TO SMALL BUSINESS IN FISCAL YEAR 1964
(in millions)

<u>Program</u>	<u>Small Business Total</u>	<u>Percent of DOD Total</u>
Major Hard Goods		
Aircraft	\$ 195	3.2%
Missile System	89	1.6
Ships	152	10.2
Tank - Automotive	78	10.4
Weapons	58	27.3
Ammunition	100	15.2
Electronics	<u>302</u>	<u>10.4</u>
Subtotal	974	5.5
Services	412	22.9
All Other		
Subsistence	307	53.0
Textiles, Clothing	176	67.1
Fuels and Lubs	180	22.8
Miscellaneous Hard Goods	307	29.1
Construction	767	56.4
Less than \$10,000	<u>1,395</u>	<u>51.5</u>
Subtotal	\$3,132	46.4

⁶⁶Office of Management Information, Navy Management Review (Washington, 1963), pp. 8-9.

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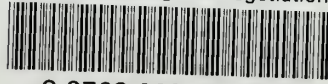
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